



**STATE BOARD OF EQUALIZATION**

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*Controller, Sacramento*

Burton W. Oliver  
*Executive Director*

(916) 920-7446

October 18, 1991

X-----

Re: X-----

Enclosed is a copy of the Decision and Recommendation pertaining to the petition for redetermination in the above-referenced matter.

I have recommended that the determination be redetermined without adjustment as explained in the Decision and Recommendation.

There are three options available to you at this point.

1. If, after reading the Decision and Recommendation, you believe that you have new evidence and/or contentions, you should file a Request for Reconsideration. No special form is required to file the Request for Reconsideration, but it must be filed within 30 days from the date of this letter and clearly set forth any new contentions. If new evidence is the basis for filing the request, the evidence must be included. Direct any such request directly to me, with a copy sent to the state Board of Equalization, P.O. Box 942879, Sacramento, CA 94279-0001, Attn: Principal Tax Auditor. I will subsequently notify you whether the request has been taken under review or whether the request is insufficient to warrant an adjustment. If I conclude that no adjustment is warranted, I will then notify you of the procedure you can follow to request an oral hearing before the Board.

2. If, after reading the Decision and Recommendation, you find that there is no basis for filing a Request for Reconsideration, but nevertheless desire to have an oral hearing before the Board, a written request must be filed within 30 days with Ms. Janice Masterton, Assistant to the Executive Director, Board of Equalization, P.O. Box 942879, Sacramento, CA 94279-0001.

3. If neither a request for Board hearing nor a Request for Reconsideration is received within thirty (30) days from the date of this letter, the Decision and Recommendation will be presented to the Board for final consideration and action.

Very truly yours,

Susan M. Wengel  
Staff Counsel

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION  
BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition for  
Redetermination Under the Sales and Use  
Tax Law of:

X-----  
Petitioner

DECISION AND RECOMMENDATION

No. Z-----

The above-referenced matter came on regularly for hearing before Appeals Attorney Susan M. Wengel on September 25, 1991 in Sacramento, California.

Appearing for Petitioner:

X-----

Appearing for the  
Sales and Use Tax Department:

Mr. Landon Carter  
Senior Tax Auditor

Protested Item

The protested tax liability for the period September 1, 1985 through June 30, 1988 is measured by:

<u>Item</u>	<u>State, Local and County</u>
Ex-tax purchases of film not reported	\$1,064,576

Contentions of the Petitioner

The film was sold to the Department of Motor Vehicles and not consumed by petitioner.

### Summary of Petition

Petitioner is a corporation which since 1985 has engaged in the business of processing film, selling embossing machines and printing state driver's licenses. Petitioner and its predecessor entities have been in the business of supplying photo identification systems since 1961 when the business first received a contract with the State of California to supply all the California driver's licenses.

During an audit by the Sales and Use Tax Department (Department) the auditor noted that petitioner purchased all its supplies tax paid except for the 35mm film purchased from Eastman Kodak. The auditor ascertained that petitioner's contract with the Department of Motor Vehicles (DMV) stated that petitioner retained title to all supplies and equipment. Film was listed as a supply item. Because petitioner did not sell the film to DMV and did not bill DMV separately for the film use tax was assessed.

Petitioner contends that it should be allowed to purchase the film ex-tax on the ground that it resells the film to DMV. Petitioner's attorney, X-----, has stated that petitioner purchases 35mm color negative film, inventories it along with other supplies and then delivers the film to DMV. Once DMV receives the film, petitioner contends that DMV exposes the film and exercises all ownership rights over the film by deciding when the film will be exposed, when it will be processed and what use will be made of the negatives. Once the film is developed by petitioner, a positive is made which becomes part of the driver's licenses produced by petitioner for DMV. The license and a microfilm copy are returned to DMV and the negatives are stored by petitioner until DMV requests that the negatives be returned or that the negatives be destroyed. Petitioner maintains a processing facility adjacent to DMV headquarters and has the equipment and personnel to handle up to 25,000 photos a day. The negatives are stored at petitioner's facilities.

The Department references petitioner's contract with DMV which covers the period March 31, 1986 through December 31, 1990. The following sections are emphasized:

"F.8 Billings will be rendered to the Department of Motor Vehicles to include all costs to the Department on the basis of a stated cost per produced license/ identification card and microfilm image acceptable to the Department of Motor Vehicles.

\* \* \*

"F.20 Furnish the Department the following supplies, services and assurances for producing driver licenses and/or identification cards and corresponding microfilm copies:

"F.20.1 35mm film as specified in the IFB.

\* \* \*

"F.25 Retain title to all equipment and supply items furnished under the contract and accept responsibility for their maintenance or replacement.

"F.26 Hold the Department harmless from liability arising from loss or damage to equipment or supplies from causes beyond the Department's control.

"G.1 X----- will provide an original invoice plus three copies. An overall summary sheet will list the following: Number of produced units (driver licenses and identification cards), including lamination and microfilm image."

The Department takes the position that by contract petitioner retains title to the film and is responsible to replace the film if it is lost or destroyed. No separate charges are made for the film as DMV is billed based on the number of licenses produced. Because the film is consumed by petitioner and not resold to DMV, the auditor assessed the use tax.

Petitioner acknowledges that it retains title to the film as per section F.25, however, X----asserts that petitioner only retains title until DMV personnel load the film into a camera for exposure. Petitioner contends that once the film is loaded into a camera, DMV exercises complete and absolute control over the film and title passes. X----- has stated that it is DMV employees who use the film, expose the film and determine when the film will be sent to petitioner for processing. By the contract, DMV reserves the authority to decide when the film is destroyed and limit any use of the film by petitioner. Petitioner notes that DMV even precludes petitioner from reclaiming the silver content of the negatives.

It is noted by this appeals attorney that the contract with DMV is operative from March 31, 1986 through December 31, 1990. The audit period extends through June 30, 1988. The auditor has scheduled numerous invoices for periods prior to March 31, 1986. It is assumed by this appeals attorney that the prior contract with DMV contained the same provisions as the contract which went into effect March 1986. The analysis applied to transactions between March 31, 1986 and December 31, 1990 will therefore be applied to the invoices scheduled for 1985 and early 1986.

#### Analysis-and Conclusion

Sales and Use Tax Regulation 1528(b)(1) provides that tax applies to sales to photo finishers of all tangible personal property used by them in printing pictures or making enlargements except property becoming an ingredient or component part of the prints, enlargements and other items sold by them. Petitioner does not contend and this appeals attorney could not find that the film becomes a component part of the driver's license produced. The film, therefore, must be found to be taxable as a consumed item unless it can be shown that the film was resold to DMV prior to any use by petitioner.

Evidence that the film was sold to DMV would best be expressed in the contract or on a sales invoice. A billing which separately states an amount for the film sold, as well as the appropriate tax, would be evidence that the film was sold to DMV. The contract, however, specifically states that petitioner is to retain title to the film. The billings to DMV are based on a set amount per driver's license produced. While this billing obviously includes the cost of the film consumed, there is no separate billing which would infer that the film was actually sold to DMV let alone that it was sold to DMV prior to any use by petitioner. It is recognized that by contract, and for security reasons, DMV severely restricted petitioner's use of the film once the licenses were printed. These restrictions, however, do not determine which entity holds title to the film. By the contract, petitioner retained title. Had it wished to sell the film to DMV and separately bill the item plus tax it could have done so. The fact that petitioner agreed to the method of billing dictated by DMV cannot form a basis for excusing petitioner from its use tax liability.

Recommendation

It is recommended that the tax liability be redetermined without adjustment.

Susan M. Wengel, Staff Counsel

9/30/1991